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E.O. 12958: DECL: 06/16/2019
TAGS: ECON EIND EFIN GM RS
SUBJECT: GOR ROLLS THE DIE ON THE CAR INDUSTRY

Classified By: ECON Minister-Counselor Eric T. Schultz for reasons 1.4 (b, d)

Summary

¶1. (SBU) In an effort to inject life into its moribund car sector, the GOR -- through Sberbank -- has committed 500 million Euros (about USD 700 million) to the Magna consortium's successful bid for GM's European car unit Opel. For the GOR, the hope is that GM technology will improve Russian car manufacturing standards. A strong automobile sector would not only increase Russia's industrial production and lower its unemployment, but it would also put Russia on the road to exporting competitive cars. For GM, this deal represents what it believes is a fortuitous conclusion to its 18-month effort to circumvent exorbitant import tariffs by concluding a joint venture with GAZ. Both sides, however, may be disappointed. While GM will license Opel production, technology transfer is not contemplated. Also, the continuing fall in Russia's demand for cars -- almost 50 percent so far in 2009 -- means that it may be years before GM sees significant returns on the deal. End summary.

The Deal

¶2. (SBU) Days after a reported May 26 call between Prime Minister Putin and Chancellor Merkel on trade and economic cooperation, Germany announced that the preferred bidder for GM's Opel unit was the Magna consortium. The deal is expected to be completed by September. If it goes through, Magna, a Canadian auto parts manufacturer, would acquire a 20 percent stake and Sberbank, a GOR-owned bank, a 35 percent stake. GM would hold on to 35 percent. Opel workers would hold the remaining 10 percent. GAZ Group, a car manufacturer based in Nizhniy Novgorod and owned by Oleg Deripaska, is slated to become the consortium's "industrial partner".

Developing Russia's Automobile Sector

¶3. (SBU) The GOR expects the deal to help develop Russia's auto industry. Sberbank President German Gref announced that the chance to acquire European production technologies at such a low price presented Russia with a unique opportunity to revive its automobile sector. GAZ promised that it would

install Opel lines in its Nizhniy Novgorod factory within nine months, after which it could produce up to 180,000 Opels a year, some of which may be for export.

¶4. (C) Heidi McCormack, Executive Director of General Motors CIS, however, warned that wholesale technology transfer was not planned under the current terms of the deal. McCormack explained that if the consortium closed factories elsewhere in Europe, some of the machine tooling might be brought to Russia. However, the new line based on the Opel platform that was being planned for the Nizhniy Novgorod factory would consist of older technology tooling manufactured in Russia and would therefore not result in any technology transfer. McCormack said she anticipated that this new Nizhniy Novgorod capacity would be running by January 2011.

GM Hopes to Pull Ahead in Russian Market

¶5. (C) McCormack said GM's hope is that by 2011 the Russian car market would be back on track to becoming the largest in Europe. She said that given a strong recovery, industry experts estimate Russia's potential to be 4 - 5 million car sales per year. McCormack conceded, however, that these same industry experts had also predicted that Russia would not go below the 1.5 million mark in car sales in 2009, but with sales figures showing continuing large scale declines (a 47 percent drop in May alone), she said the immediate future of the new partnership was bleak. Still, McCormack believed that the market would rebound and that the Opel deal would

place GM in a good position in the Russian car market once it did so.

¶6. (C) McCormack said GM welcomed the Opel decision. It represented the culmination of 18 months of negotiations with Deripaska and his GAZ Group for a USD 1 billion joint venture agreement. McCormack acknowledged, however, that the GOR, via state-owned Sberbank, would be a difficult partner or "krisha" (literally "roof", Russian term for purchased business protection which typically applies to protection provided by organized crime entities). While GOR patronage would undoubtedly provide benefits, such as continued protection in the form of high import tariffs that would protect its Russian manufacturing and subsidies for car loans geared to GM/GAZ products, the GOR's expectations of substantial free technology transfer would be challenging to manage.

Can It Succeed?

¶7. (C) Mikhail Ganelin, a Troika Dialog sector analyst, told us that the deal made sense for GAZ and GM. Opels are very popular in Russia because they are relatively inexpensive, yet of better quality than the domestic Lada brands. Also, given the failure of its recently launched Sibir line, GAZ needed to produce a new model.

¶8. (C) Stanley Root, an auto expert at PWC, also said there was commercial strength to the deal. He told us that it could solve many of the problems besetting Russia's auto sector at one stroke. He said the GOR had always thirsted for cutting-edge technology and it believed the Magna deal would provide this. In addition, the weakest link in the sector has been its lack of domestic car component manufacturing. Root told us that not one of Russia's component manufacturers met western standards. Consequently, everything had to be imported, at tariffs ranging from 5 to 20 percent. If the deal solidified Magna's commitment to the Russian market and it increased its domestic manufacturing, it would not only provide the components needed, but it would likely spur other foreign auto component producers to set up

operations in Russia.

¶9. (C) Other local analysts, however, question the motivation and commercial soundness of the Opel deal. Arguing against the commercial viability of expanding into the Russian market right now, Ford CFO Chris Caulfield told us that Ford continued to have concerns about Russia's dying dealership network and frozen consumer credit. Other analysts told us that since Opel expects to have over USD 3 billion in losses for 2009 and GAZ is in deep debt, the deal is unlikely to be successful. These analysts posited political motives as the reason for the deal -- such as the GOR,s desire to maintain German support on Nord Stream. (Note: the Magna consortium pledged that few German jobs would be cut and no German factories would be closed. End note.)

Comment

¶10. (C) For foreign producers, including automobile manufacturers, Russia's consumer market continues to tantalize. Many, like GM, hope that further investment will enable them to take advantage of an anticipated upswing, despite increasing short-term losses as Russia's deep economic contraction worsens. However, despite rising oil prices, it is not at all clear that the recession is over for Russia. For that reason, GM,s plunge may be premature, commercially speaking. That said, GM had little choice given its condition and little to lose on its Russian gamble.

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